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First report of the Secretary-General pursuant to paragraph 3 of resolution 1859 (2008)

I. Introduction

1. The present report is submitted pursuant to paragraph 3 of Security Council resolution 1859 (2008), in which the Council requested me to report to the Council on a quarterly basis, with the first briefing no later than 31 March 2009 and with a written report on a semi-annual basis, on the activities of the Development Fund for Iraq and the International Advisory and Monitoring Board, including on progress made in strengthening financial and administrative oversight of the Development Fund.

II. Background

2. The Development Fund for Iraq established pursuant to resolution 1483 (2003) holds the proceeds of oil export sales from Iraq, as well as the transferred balances from the United Nations oil-for-food programme and other frozen Iraqi funds.

3. In 2003, the Security Council also decided that all export sales of petroleum, petroleum products and natural gas from Iraq shall be made consistent with prevailing international market best practices, to be audited by independent public accountants reporting to the International Advisory and Monitoring Board in order to ensure transparency, and all proceeds, except as provided in paragraph 4 below, from such sales shall be deposited into the Development Fund for Iraq until such time as an internationally recognized, representative Government of Iraq is properly constituted.

4. The Security Council further decided that 5 per cent of the proceeds referred to in paragraph 3 above shall be deposited into the Compensation Fund established in accordance with resolution 687 (1991).

5. The International Advisory and Monitoring Board, as the audit oversight body for the Development Fund for Iraq, was established to fulfil the mandate set forth in resolution 1483 (2003). That mandate has been subsequently extended under resolutions 1546 (2004), 1637 (2005), 1723 (2006), 1790 (2007) and 1859 (2008). By resolution 1859 (2008), the Security Council also extended the immunity of the petroleum and petroleum products and proceeds deposited in the Development Fund until 31 December 2009.

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6. The International Advisory and Monitoring Board has as its members representatives of the Secretary-General, of the Managing Director of the International Monetary Fund (IMF), of the Director General of the Arab Fund for Social and Economic Development, of the President of the World Bank and of the Government of Iraq. In addition, the Advisory Board continues to involve the Iraqi Board of Supreme Audit and the Committee of Financial Experts in its work to ensure continuity.

7. The International Advisory and Monitoring Board has met 25 times since December 2003, including twice in 2009. All documentation, including press statements, the minutes of all Board meetings, completed audit reports and key documents related to the mandate and operations of the Board continue to be available on its website (www.iamb.info).

8. From the time of the inception of the Development Fund for Iraq to 31 December 2008, the International Advisory and Monitoring Board has been informed that about $165.1 billion has been deposited in the Fund from the export sales of oil and oil products. $10.4 billion has also been deposited with the Development Fund from the balance of the oil-for-food funds held under escrow by the United Nations, and a further $1.5 billion has been deposited as proceeds from frozen assets.

9. In 2006, the Council of Ministers of Iraq established the Committee of Financial Experts to work alongside the International Advisory and Monitoring Board and take over the tasks of the Board in monitoring the Development Fund for Iraq upon the expiration of the Board's mandate. The Committee of Financial Experts is headed by the president of the Board of Supreme Audit and is responsible directly to the Council of Ministers. Since its inception, the Committee has been working closely with the Advisory Board and has attended all of its meetings. The Committee itself meets regularly and has increased its role in the follow-up to and implementation of recommendations contained in independent audit reports commissioned by the Advisory Board.

10. In April 2009, the Controller of the United Nations, Jun Yamazaki, my designated representative on the International Advisory and Monitoring Board, briefed the Council on the activities of the Development Fund for Iraq and the Advisory Board.

11. The issues covered in the present report were on the agendas of the meetings of the International Advisory and Monitoring Board held in Amman on 2 and 3 April and in Vienna on 22 and 23 July 2009, and reflect recent activities with regard to both the Board and the Development Fund for Iraq.

III. Recent activities with regard to the Development Fund for Iraq and the International Advisory and Monitoring Board

12. At the meeting in Amman, the International Advisory and Monitoring Board discussed the Security Council's request for briefings by IMF and World Bank representatives, pursuant to paragraph 4 of resolution 1859 (2008). It was reiterated that individual representatives on the Board should brief their respective organizations in their individual capacities, as had been the practice. IMF and the World Bank had responded accordingly to the Council request.

13. When the date of the end of the mandate, 31 December 2008, was approaching, the Chairman of the International Advisory and Monitoring Board addressed a letter dated 27 October 2008 to the Prime Minister of Iraq, Nuri Kamel al-Maliki, recommending that the Committee of Financial Experts take over the tasks that had been entrusted to the Board. In April 2009, the Board again wrote to the Prime Minister, reiterating its belief that the Committee was ready and able to take over the tasks currently entrusted to the Board.

14. I recognize the view of the International Advisory and Monitoring Board that the Committee of Financial Experts is ready to assume the oversight responsibilities and conduct competent and independent oversight of the Development Fund for Iraq. As the Security Council prepares to discuss this matter, including the mandate of the Development Fund for Iraq at the end of 2009, it will be important to ensure that a proper succession mechanism and process be considered.

15. The external auditor provided regular briefings on the progress of the 2008 audits to the International Advisory and Monitoring Board. The first draft audit report on the Development Fund for Iraq, to 31 December 2008, was reviewed by the Board at the April 2009 meeting, and the final audited report was reviewed at the July 2009 meeting in Vienna. The audit report has also been submitted to the Ministry of Finance and to the Iraqi Council of Ministers and made available to the public on the Board website and the website of the Committee of Financial Experts (www.cofe-iq.net).

16. The management letter on internal controls and the management letter for spending ministries for the period from 1 January to 31 December 2008, produced by the external auditor, are also posted on the Board website.

17. The audit continues to highlight key issues of concern regarding weaknesses in controls over oil extraction and use of the resources. Access to some ministries and regions had been delayed, but the issue was resolved through the intervention of the Committee of Financial Experts, and the fieldwork is now complete.

18. The audit also continues to be heavily qualified, and the Board expressed concerns that certain issues, including the continued non-deposit in the Development Fund for Iraq of cash sales of fuel oil by the State Oil Marketing Organization (SOMO), had not been resolved.

19. The Board has highlighted these concerns in publicly issued press releases and minutes of its meetings.

20. Recognizing the competence and capabilities of the Committee of Financial Experts, aided by the Board of Supreme Audit, the International Advisory and Monitoring Board has already entrusted much of the detailed follow-up and investigation of audit findings to the Committee. The representatives of the Government of Iraq, the Committee and the Board of Supreme Audit reported regularly to the Advisory Board on actions taken to follow up on outstanding audit recommendations.

21. The International Advisory and Monitoring Board remains concerned that one of its earliest recommendations from 2004 concerning oil metering remains incomplete. The external auditor's enquiries revealed that the overall metering system installation percentage was 33 per cent as at 31 December 2008. In the absence of an overall comprehensive system of controls over petroleum extraction,

the external auditor was not able to reconcile extracted petroleum with SOMO records of quantities received and quantities consumed internally. However, the external auditor has reconciled the petroleum quantities received by SOMO with petroleum export sales.

22. Oil experts from the Iraqi Ministry of Oil briefed the International Advisory and Monitoring Board on oil metering. Some progress has been made, including in commencing implementation of a code for fiscal and custody measurements for hydrocarbon fuels by the Ministry of Oil. However, much remains to be done before a fully operational control and measurement system over oil production, distribution and export sales can be comprehensively implemented. Indications from the Ministry of Oil point to implementation by 2011 at the earliest.

23. Prior to 31 December 2007, SOMO engaged in barter transaction with the Government of the Syrian Arab Republic and private companies for exports of petroleum and petroleum products. The value of the barter transactions with the Syrian Government as recorded by SOMO from inception until 31 December 2008 is $750,865, and the value of barter transactions with private companies from inception until 31 December 2008 is $348,815. I welcome the finding by the external auditor, KPMG, that no barter transactions took place during 2008.

24. In order to enhance the transparency and accountability of the Development Fund for Iraq, and taking into account the audit findings of the external auditor, the International Advisory and Monitoring Board called for the timely monthly publication of the Fund's financial statements on the website of the Committee of Financial Experts. The Board also called on the Committee to develop a realistic action plan and time frame to resolve the audit qualifications from KPMG in their audit opinion. The Board requested the Committee to report to it every other month on progress on those points; it is expected that such reports will be published on the websites of the Board and the Committee. The Board also urged the Committee to continue working expeditiously in supporting the necessary steps for the early passing in Parliament of laws and regulations concerning organization structures, job descriptions and internal control systems and the development of a time-bound action plan, endorsed by the Council of Ministers, to implement a comprehensive oil-measuring system.

25. I welcome the steps taken by the Committee of Financial Experts, in particular its proactive engagement with the Council of Ministers, which has led to Council directives that all ministries form working committees to address organizational and information systems issues raised by the Development Fund audits. The Committee will monitor progress by the ministries in implementing those directives, and the Board of Supreme Audit will be reporting to the Council of Ministers on the follow-up to a survey conducted by the Board of Supreme Audit that identified weaknesses in internal controls at the ministries.

26. I also welcome the detailed follow-up reports from both the Committee of Financial Experts and the Board of Supreme Audit which are published on the website of the International Advisory and Monitoring Board. Those reports note that progress is being made, but it is apparent that much remains to be done to fully implement the audit recommendations and strengthen the system of internal controls. The Advisory Board reiterated its earlier recommendation that the Government of Iraq intensify efforts to follow up on frozen Iraqi assets held abroad, including through considering the need for a separate entity to handle those efforts. I

note that the Committee of Financial Experts has approached the Iraqi Ministry of Finance on this matter.

27. The representative of the Committee of Financial Experts provided regular briefings to the International Advisory and Monitoring Board on Committee activities, the work programme and the coordination of work with the Board to enable a smooth handover of oversight responsibility from the Board by the end of 2009. The Committee has initiated the appointment process for the 2009 auditor as part of its action plan for 2009. The Board agreed that the 2009 audit should cover the period from 1 January to 31 December 2009, with an interim audit for the period 1 January to 30 June 2009. The interim audit will be undertaken under the high-level oversight of the Board and the final audit is expected to be undertaken under the full oversight of the Committee as the Board mandate is scheduled to have expired by that time. The Board approved the process and concurred with the recommendation of the Committee to proceed with the audits.

28. As a matter of priority, control systems need to be improved in key Iraqi agencies, including SOMO, and in the various Iraqi ministries. The International Advisory and Monitoring Board will work closely with the Committee of Financial Experts and the Government of Iraq to monitor and report on the progress made on strengthening financial and administrative oversight of the Development Fund for Iraq.

29. The Advisory Board noted that in 2008 the United States Attorney's Office issued press releases relating to the court proceedings resulting from the Volcker inquiry into the oil-for-food programme, indicating fines imposed on various companies and individuals involved. The fines imposed as a result of the court proceedings were to be deposited into the Development Fund, for which cheques were issued payable to the Fund. The external auditor confirmed that amounts totalling approximately $50 million, as a result of the court proceedings in the United States of America, were deposited in the Development Fund account during the 2008 financial year.

30. The next meeting of the International Advisory and Monitoring Board, with the participation of the Committee of Financial Experts, is tentatively scheduled for December 2009. The Committee will be meeting separately on a regular basis in the interim.